CHASE

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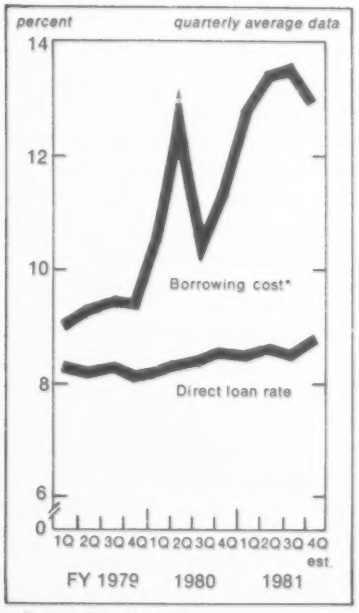
Eximbank in A Double Bind

The U.S. Export-Import Bank is caught between two mandates: remaining "self-sustaining" by keeping its borrowing and lending costs in line, and providing subsidized export financing support that is "competitive" with that offered by European and Japanese governments. It has not been able to do both. The bank's policy of offering highly subsidized—and competitive—interest rates on its long-term export financings over the past few years, despite steadily rising market interest rates, has come home to roost. The Eximbank now projects a potential operating loss of $10 million in fiscal 1981 and as much as $100 million in 1982.

Faced with declining net income, the Eximbank's new chairman announced revised loan guidelines in mid-July to shore up the bank's finances. Most important, interest rates on long-term direct loans were raised to 10.75% from 8.75% and a two-percentage-point fee on Eximbank credit values was imposed. But a 1978 international agreement on government-backed export loans specifies minimum allowable interest rates far below these levels (7.75% on loans to buyers in developing countries). And most European and Japanese exporters are currently offering terms at these minimums, thanks to continued large subsidies from their official export credit agencies. Consequently, U.S. exporters risk the potential loss of millions in big-ticket export contracts to their European and Japanese counterparts.

Eximbank lending rates versus borrowing costs



* Federal Financing Bank

Thus, a lot is riding on the October 5 round of OECD-sponsored negotiations to lift the agreement's minimum interest rates nearer to market levels. The failure of the 22 countries participating in the export credits arrangement to consent last spring to linking minimum rates to some measure of market rates has produced a concentrated effort to boost interest-rate minimums by at least two to three percentage points—and quickly. One breakthrough has been an international accord establishing an interest-rate minimum of 12% for exports of competing aircraft—an export item excluded from the current export credits pact. Nonetheless, if the United States and its negotiating partners fail to agree to a sizable generalized increase in minimum allowable export credit rates next month in Paris (and to set up a mechanism for periodic rate adjustments), many large U.S. exporters will be confronted with highly uncompetitive export financing terms for the foreseeable future. At the same time, however, foreign governments sticking to their current financing policies will continue shouldering the burden of ballooning export-finance subsidies.

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Danish policy austerity suggests another GNP decline this year.

The Danish government is apparently sticking to its restrictive policy stance, making likely another decline in real GNP this year after a 1% drop in 1980. Owing to recession in Germany and Sweden, even the export sector is unlikely to show any growth, despite the substantial fall in the kroner's effective exchange rate that has resulted from a stronger U.S. dollar and U.K. pound. The restrictive policy has aggravated unemployment, which is projected to average 8.5% of the labor force in 1981, but it is lowering the annualized inflation rate—which has fallen to 11.6%. The trade balance has also improved, but high interest charges on large overseas debt promise substantial current-account deficits for the foreseeable future. On the domestic front, public finance remains a serious concern. The government budget for 1982 projects a rise in the total borrowing requirement to kr. 80 billion ($10.7 billion), which is unnerving the bond markets. The effective yield on 20-year state bonds recently hit 21.8%, and although yields have fallen slightly since then, long-term rates remain exceptionally high.

Swedish devaluation accompanied by measures to limit inflationary impact.

Despite the moderation embodied in a two-year wage agreement announced in February 1981—which allows for a 7% wage rise this year and 6% next year—production costs have continued to rise faster in Sweden than in many other countries. The exporting industries have begun to suffer, and their problems have been compounded by the kronor's strength vis-á-vis most West European currencies. Responding to the latter problem, the government devalued the kronor by 10% on September 14. To ensure that the kronor's decline does not get reflected in higher costs, the authorities have announced a price freeze for the remainder of 1981 together with a reduction in value-added taxes. In addition, the government has proposed that corporations set up special investment accounts with the central bank so that increases in profits are channelled toward new fixed investment rather than toward financing inflationary wage demands. Finally, the central bank has indicated that the devaluation will not alter its current tight monetary stance. In sum, the stage would seem to be set for improvement in the Swedish economy and containment of inflation. Inflationary pressures may intensify, however, if unemployment begins to fall in the early part of next year.

Imports and debt costs widen Turkey's external deficit.

Despite rapid export growth, the Turkish authorities anticipate a current-account deficit of over $3 billion this year, up from $2.7 billion in 1980. Exports in dollar terms rose 50% in the first half of 1981 to $1.95 billion, and worker remittances for January-May were up 26% from their year-earlier level. At the same time, however, imports in dollar terms advanced 48% to $4.43 billion, widening the trade deficit to $2.48 billion—a level that exceeds the government's $4.2-billion projection for 1981 as a whole. Furthermore, high U.S. interest rates are raising debt interest payments, countering the beneficial effect of increased worker remittances. Still, these developments must be viewed in the context of an economy that has resumed growth after almost three years of stagnation.

Argentine exchange-rate policy reaping benefits.

Argentina's current economic recession is characterized by rising unemployment and climbing inflation. Real GDP declined 1.6% in the first half of 1981, and unemployment in Buenos Aires is approaching 5%. Meanwhile, the annualized rate of consumer price rise jumped to 114% in August from 82% earlier this year. These various results stem from both the previous policy of peso overvaluation and the turbulence in the foreign-exchange market earlier this year. A series of devaluations has helped industrial exports but has also pushed up import prices. With relative calm prevailing in the markets in the past few weeks, the sharp peso devaluations have begun to yield trade dividends. A $345-million trade surplus was posted in the second quarter, in contrast to the previous quarter's $520-million deficit. The return to a more competitive trade environment should lift industrial output, although it will come too late to prevent an overall GDP decline for the year. It will, however, improve the current account and should help foster a rebound in economic activity next year.

Mexico on positive economic course, says President Portillo.

In his annual state of the nation message earlier this month, Mexican President Lopez Portillo applauded Mexico's recent 8% real GDP growth; the hike in proven oil and gas reserves to 72 billion barrels; and the creation of 3.4 million new jobs over the past five years. On the negative side, however, Portillo expressed concern about rising inflation; the larger trade deficit despite strong oil revenues; and the pressure on money creation stemming from the fiscal deficit. On balance, the presidential assessment suggests that Mexico is on the right economic course, and will likely continue on this path for the balance of the current presidential term, with no fundamental policy shifts foreseen.

Japanese domestic debt financing efforts meet with difficulty.

The Japanese government is having problems raising funds to finance its deficits through the issue of long-term national bonds. To keep debt financing costs low, the government pressures syndicates of financial institutions into underwriting new issues at below-market yields. As government debt has soared and as high U.S. interest rates have pulled up secondary-market yields, however, the underwriting syndicates have become increasingly reluctant to accept new issues at the existing terms. Only 1.08 trillion yen (\$4.9 billion) of the planned 10-year bond issue of ¥6.8 trillion were sold in the first three months of the fiscal year. The underwriting syndicates refused to accept new issues in both July and August, which forced the government to sell the issues to its Trust Fund Bureau and through special private placement. Given these difficulties, the Ministry of Finance has agreed to a yield increase for the September issue. Such an increase may necessitate a rise in the bank debenture and long-term prime lending rates, but is not expected to affect short-term rates. The difficulty in selling national bonds is expected to put further pressure on the government to restrict expenditures to reduce its bond issue for deficit financing.

Malaysian policy of local ownership progressing slowly.

Malaysia's new economic policy goal of placing ownership of 30% of the country's industrial and commercial assets in ethnic Malay hands by 1990 moved a step closer to realization on September 7. On that day the National Equity Corporation, a Malaysian government body, purchased nearly eight million shares (valued at about \$132 million) of the Guthrie Corporation, a London-based diversified company, 60% of whose assets consist of Malaysian plantations. Together with shares acquired earlier, the latest equity investment gives Malaysia a majority interest in Guthrie. The government already owns a 25% interest in Sime-Darby, the other giant plantation and trading company with interests in Malaysia. It is therefore possible that a consolidation of Malaysia's interests in the two companies is being contemplated. The New Economic Policy is now more than halfway through its 1970-1990 span, with progress toward the 30% target lagging —only 12% of industry and commerce's assets were in Malay hands last year. Moreover, a large part of this share was held by the National Equity Corporation and other government entities, for eventual distribution to individual Malays.

A squeeze on Nigerian oil receipts likely to produce a policy reassessment.

The sustained weakening of world oil demand has trimmed back projections of Nigeria's 1981 export receipts, over 90% of which derive from oil sales. Despite the 10% discount (announced August 26) on the \$40 per barrel official price, there are still no signs of a significant upturn in output, which in August barely exceeded one-third the January level of 2.1 million barrels per day. With exports currently running only slightly above 500,000 barrels per day, and with pressure from refiners for further price reductions, even a moderate upturn in output toward yearend is unlikely to produce oil export receipts exceeding \$14 billion—which would be 40% below last year's figure. The impact of the shortfall on the budget—which depends on oil revenue for about 80% of its funds—and on the balance of payments will be cushioned somewhat by the healthy level of international reserves and Nigeria's underborrowed position on world financial markets. Nevertheless, a projected current-account deficit of \$8-9 billion and a \$6-7-billion budget deficit will present policymakers with very difficult choices.

Mortgage Market Weakness Pronounced

Although expenditures on new housing have fallen off quite sharply recently, the decline in the growth of household mortgages has been even more precipitous. In the first half of this year, household mortgages outstanding increased at a seasonally adjusted annual rate of $77 billion, equivalent to only 75% of household residential investment (or investment in new homes). This contrasts markedly with the experience of the late 1970s, when household mortgages outstanding rose by 110% of household residential investment.

During most of the late 1970s, when the real cost of mortgage financing was relatively low, households were inclined to borrow heavily in the mortgage markets. Moreover, the regulatory climate and market conditions were such that lenders were more willing to supply mortgage credit. Such an environment made it easier for consumers to tap the accumulated equity in their homes as a source of purchasing power.

Conditions have obviously changed since then. Financing costs have jumped sharply relative to income. Over the last 12 months, mortgage financing costs have risen by over 25%, while personal income has increased only 12%. Consequently, fewer individuals qualify for mortgages. And for those who do qualify, the high real cost of mortgage credit has decreased the attractiveness of such credit as a source of purchasing power. Moreover, the current profit squeeze on thrift institutions has made them more cautious in supplying funds, as has the slow deposit inflows they have experienced. In addition, tight credit market conditions have depressed sales of existing homes, and have therefore limited the tendency for households to "trade up" to larger homes requiring larger mortgages.

The use of "creative financing" techniques—whereby the seller provides some of the financing to the buyer—is also contributing to the slowdown in mortgage credit growth relative to residential investment. While this development has actually offset to some extent the effect of tight mortgage market conditions on the housing market, it has limited the ability of sellers to utilize house sale proceeds for such other uses as consumption.

Given the further hikes in mortgage costs in recent months, as well as the trend toward tightening non-mortgage rate terms by a number of lenders, it is likely that mortgage credit will continue to grow slowly, at least through yearend. Such mortgage market conditions may restrain consumption in the fourth quarter, thereby dampening the stimulatory effects of the October 1 tax cut. However, the slow growth in this sector of the credit markets may allow "room" for the prospective large Treasury borrowings in coming months without causing any further rise in interest rates.

Surge Seen in M2 Growth

It seems virtually certain that the broader measure of the money supply, M2, will accelerate sharply in October. And in view of the Federal Reserve Open Market Committee's recent strategy of placing greater weight on the behavior of M2 in determining monetary policy, the question arises of how the Federal Reserve will interpret or react to the surge.

One reason to expect M2 to accelerate in October is that the all savers certificates—included in M2—come on line then. Their yields are equivalent to 70% of the investment yield on one-year Treasury bills. From October 1 to October 5 (the date of the next one-year bill auction) the rate institutions may pay on these certificates is 12.61%. This yield is higher than yields on tax-exempt municipal notes of similar maturities. Moreover, since the one-year Treasury bill rate has fallen by over 100 basis points since the last auction, the rate on the certificates based on the next auction will probably be much lower. Consequently, a large move into these certificates in early October is probable.

Much of the funds channeled to all savers certificates will surely come from money market certificates and money market funds. This would not affect M2, which consists of currency, demand and other checkable deposits, small time and savings deposits, overnight repurchase agreements and Eurodollar deposits, and money market mutual fund shares. However, quite a few billion dollars are likely to move into these certificates from sources not included in M2, including tax-exempt bond funds and direct holdings of market securities.

Another source of the anticipated bulge in M2 will be shifts into money market funds by such institutional investors as trust departments—a process already begun. The recent sizable drop in money market rates has not yet been matched by the yields on money market funds. This is because money fund yields are based on yields on instruments purchased over the last month or two, and thus still reflect earlier higher interest rates.

Given these influences, M2 growth in October is very likely to exceed the latest publicized Federal Reserve target, even if the economy and the demand for money and credit are weak. But the money markets are highly uncertain about the Federal Reserve's reaction to this bulge. If monetary policy is based on keeping M2 growth within the latest announced targets, the bulge would suggest some tightening. However, it is doubtful whether the Federal Reserve will react in such a knee-jerk fashion. Unfortunately, the Federal Reserve has not given any indication as to just how it might adjust the M2 targets—or if it will at all. One possibility, and one certainly in keeping with past policy, would be to create a new aggregate called "M2-adjusted" that would purge any estimated effect of the introduction of the all savers certificate on M2 growth.

Europe, Canada & U.S. Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	INDUSTRIAL OUTPUT		GNP IN 1980		BALANCE OF PAYMENTS						MONEY AND BANKING							COUNTRIES
												12-month changes				central bank rate	exchange rate in U.S. dollars		
		latest data	12-month change	in billions of dollars	real growth	latest data	reserves (less gold) in $ million	12-month change	months of imports covered	use of IMF credit, millions of dollars	current influences on payments	latest data	consumer prices	latest data	money supply(M1)	September 23, 1981		current monetary conditions	
Austria	Domestic demand stays weak, but export strength boosts aggregate demand.	Mar.	+ 1%	75.8	+ 3.6%	July	4,497	+ 8%	2.5	0	Trade deficit set to narrow.	June	+ 6%	May	+ 9%	6.75%	.0618	Interest rates await fall in German rates.	Austria
Belgium	Domestic and export demand continue weak; fiscal deficit remains high.	May	— 2%	118.9	+ 1.5%	July	5,753	— 33%	1.0	0	Reduced export competitiveness keeps trade deficit widening.	July	+ 8%	Mar.	+ 3%	13.00%	.02442	Interest rates rise owing to increased pressure on franc	Belgium
Britain	Economic decline seems to have ended, but sustained recovery still looks some way off.	July	— 6%	518.7	— 1.4%	July	15,780	— 29%	1.7	423	Trade data still unpublished but signs are of continuing surplus.	Aug.	+ 12%	June	+13%	14.00%	1.8040	Money growth continues to exceed official target.	Britain
Denmark	Economic output remains depressed.	May	+ 13%	67.1	— 0.8%	July	2,851	— 5%	1.9	0	Current-account gap narrowed in IIQ; first-half deficit was kr. 6.36 billion.	May	+ 12%	Dec.	+10%	11.00%	.1400	Concerns over budget deficit keep rates high.	Denmark
Finland	Exports continue to bolster economy; 2% real GDP growth projected for 1981.	May	+ 7%	51.0	+ 6.0%	July	1,542	— 24%	1.4	75	Jan.-July trade surplus of fmk. 584 million vs. fmk. 3-billion deficit year ago.	July	+ 13%	Feb.	+ 2%	9.25%	.2260	Monetary conditions remain restrictive.	Finland
France	Further measures taken to stimulate demand; 3.5% real GDP target set for 1982.	June	— 5%	651.1	+ 1.2%	July	24,845	— 9%	2.4	0	Current-account gap set to widen as economy revives.	July	+ 13%	Apr.	+10%	9.50%	.1830	Little scope for drop in rates with franc under pressure.	France
Germany	Exports and export orders surge; restrictive 1982 budget proposed.	July	— 3%	827.7	+ 1.8%	July	47,384	— 7%	3.4	0	Trade balance improves in June-July; '82 current-account surplus possible.	Aug.	+ 6%	May	+ 2%	7.50%	.4337	Rates weaken somewhat in response to stronger mark.	Germany
Greece	Government resigns in advance of October general elections.	Dec.	+ 3%	38.2	+ 1.6%	June	682	— 18%	0.6	40	Current-account deficit widening.	June	+ 23%	Dec.	+15%	20.50%	.0210	Credit remains tight.	Greece
Ireland	Industrial output rose slightly in June, but recent tough budget precludes significant recovery.	Apr.	0	17.1	+ 2.1%	July	2,209	— 11%	2.5	0	Trade deficit expanding sharply: £243 million in July vs. £84 million in May.	May	+ 17%	July	+16%	15.00%	1.6050	Rates surge since July owing to money growth curbs.	Ireland
Italy	Industrial production falls sharply, with no upturn expected before next year.	July	— 2%	394.9	+ 4.0%	July	17,941	— 21%	2.3	0	Import deposit requirement to be renewed.	Aug.	+ 19%	Apr.	+12%	19.00%	.00086	No rate easing likely before EMS readjustment.	Italy
Netherlands	New coalition formed in wake of May elections; tight preliminary 1982 budget proposed.	May	— 6%	159.9	+ 1.0%	July	9,043	— 15%	1.5	0	Current account expected to move into surplus this year.	July	+ 7%	May	+ 3%	9.00%	.3922	Guilder stays strong in EMS; rates move with Germany.	Netherlands
Norway	Recent election showed swing to right, but business conditions unlikely to change for a while.	June	— 3%	55.4	+ 3.6%	July	5,481	+ 16%	4.3	0	Small deficit in Aug.; year-to-date trade balance shows kr. 9.23 bn. surplus.	July	+ 14%	Apr.	+15%	9.00%	.1670	Monetary conditions remain tight.	Norway
Portugal	Tighter fiscal stance and world recession offer little prospect of strong growth.	Sept. '80	0	24.1	+ 3.9%	June	576	+ 21%	0.8	62	Export growth constrained by weak external demand.	June	+ 18%	Mar.	+22%	18.00%	.0158	Bank credit growth under stricter official control.	Portugal
Spain	Both domestic and external sectors remains weak.	Dec.	+ 5%	208.5	+ 0.5%	June	10,427	— 12%	3.7	20	Tourist season proved better than expected.	June	+ 14%	May	+12%	8.00%	.01062	Monetary growth slowing.	Spain
Sweden	Economy remains depressed, with unemployment rising.	May	+ 20%	124.3	+ 2.3%	July	3,633	+ 3%	1.5	0	Devaluation will enhance trade balance's longer-term prospects.	July	+ 13%	n. a.	—	12.00%	.1796	Central bank sees little scope for money policy easing.	Sweden
Switzerland	Most indicators point to further decline in business activity.	Mar.	— 3%	99.8	+ 2.4%	July	10,227	— 19%	4.0	0	Current-account upturn owes to narrowing trade gap and invisibles inflow.	Aug.	+ 7%	May	0	6.00%	.5076	Rates rise with money policy tightening.	Switzerland
Canada	Strong second-quarter GNP advance fueled by consumer income gains and investment spending.	June	+ 6%	246.5	+ 0.1%	Aug.	3,290	— 18%	0.5	0	Canadian dollar depreciation helps export growth.	Aug.	+ 13%	Aug.	+ 4%	19.67%	.8347	Central bank and prime rates decline slightly.	Canada
United States	Economic activity slumping in response to continued monetary restraint.	Aug.	+ 8%	2,626.1	— 0.2%	July	17,713	+ 66%	0.8	0	Current-account surplus of $1.07 billion posted in IIQ, buoyed by services.	Aug.	+ 11%	Aug.	+ 6%	14.00%	—	Dollar weakens as money market rates fall.	United States

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World Interest Rates

market rates of Sept. 23, 1981; bond yields as of Sept. 18, 1981

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	14.00 penalty-large banks 17.00	19.67	14.00	13.00	9.50	7.50	19.00 penalty rate 22.00	9.00	6.00	7.25
Day-to-Day Money	15.00 Sept. 24	20.00	14.00	12.30	18.50	12.00	20.125	10.75	24.00	7.4375
Treasury Bills 91-day, Middle Rates	14.17 discount basis	19.40	14.5625	15.75	n. a.	n. a.	18.749 65-day	no dealing	no market	5.625 two-month
Commercial Paper prime, 3-month, asked	15.00 finance paper discount basis	19.50 finance paper 15% tax w/h	13.6256	12.90 Certified	19.00 interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	15.15	19.60 15% tax w/h	14.625	12.90 Certified	not traded	9.90	22.40	no market	10.875	no market
Government Bonds Long-term, new and old issues, average yield	14.54	17.30	15.40	10.3637 20% tax w/h	16.66	10.66	21.16	12.13	6.11	8.47
Industrial Bonds prime, long-term, new and old issues, average yield	15.55 Aa Industrials	18.125	16.72	17.015	17.78	10.95	21.37	13.52	7.00	7.29
Bank Short-Term Rate to Best Borrowers (prime rate)	19.50	21.25	15.00	18.00	18.50	14.50	22.50 ⅛ quar'ly fee on outstdng.	14.50	9.50	6.75
Bank Time Deposits 3-month	15.625 Cert. of Dep.	19.60	15.25	15.40	19.00	12.30	10.75	12.375 large deposits	9.75 residents only	4.25 20% tax w/h
Eurocurrencies 3-month, asked	16.625	no market	15.375	no market	26.50	11.875	no market	12.375	10.9375	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8347	1.8040	.02442	.1826	.4337	.00086	.3922	.5076	.00439
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	2.771 *D*	1.5965 *P*	2.06 *D*	9.8631 *D*	4.9436 *P*	16.51 *D*	4.188 *P*	5.685 *P*	9.473 *P*

Eurodollar Deposits
(London, interbank, bid)
September 24

7-day	13.4375
1-month	16.125
3-month	17.4375
6-month	17.50

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	−1.7893
U.S.-Canada Treasury Bills	−1.3104
U.S.-Canada Finance Co. Paper	−1.4616
Eurodollars-U.K. Local Auth. Deposits	n. a.

Eurobonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	17.00
Over 7 yrs.	17.00
DM Bonds	
7 yrs. and under	10.50
Over 7 yrs.	10.5625

Gold Price
London afternoon fixing
456.50
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	10.9 (Aug.)	12.7 (Aug.)	11.5 (Aug.)	13.4 (July)	6.0 (Aug.)	19.2 (Aug.)	7.4 (Aug.)	4.4 (July)
Industrial production*	7.5 (Aug.)	6.3 (June)	−5.8 (July)	−4.5 (June)	−2.7 (July)	−2.0 (July)	−2.6 (March)	1.9 (June)
Trade balance† *(billions of local currency units)*	−$1.46 (July)	C$0.44 (July)	£0.31 (Feb.)	−FF3.85 (July)	DM3.66 (July)	−Lit.800 (July)	−SF0.99 (Aug.)	¥547 (July)
Money supply (M1)*	6.2 (Aug.)	4.0 (Aug.)	12.5 (June)	9.5 (April)	2.0 (May)	11.8 (April)	0 (May)	−2.4 (April)
Velocity of money (M1)*	12.9 (March)	−0.14 (Dec.)	9.8 (Dec.)	n. a.	0.7 (March)	4.6 (March)	n. a.	13.0 (March)
Reserves minus gold *($ million, change from previous month)*	−720 (July)	−729 (July)	−1,292 (July)	−603 (July)	−1,264 (July)	562 (July)	−1,915 (July)	−316 (July)

* Percent change from 12 months earlier.

† Figures are only for the month indicated.

Trading Companies: A Bit of Japan in the U.S.

The continuing strength of the Japanese economy coincident with economic malaise in the United States has made U.S. admiration of Japan a widespread and growing national pastime. Americans are duly impressed that Japan—resource-poor and utterly dependent on imports of raw materials—has managed to achieve and sustain high productivity and economic growth with relatively low inflation, while the resource-rich U.S. economy remains stagnant. They wonder whether there are any lessons the United States can learn from Japan.

Many American businessmen and "Japanologists" maintain that social and cultural influences are largely responsible for the Japanese economy's remarkable vigor. They attribute Japan's economic growth to such sociocultural characteristics of its people as group-orientation, patience, discipline, and a deep respect for education (shared by a homogeneous population), which are deeply rooted in Japan's Confucian and Buddhist ethics. Others attribute Japan's economic success to a survival mentality that stems from a shortage of arable land and natural resources and severe overcrowding. Still another view holds that Japan's destruction during World War II gave it the "opportunity" to rebuild—with U.S. aid—a modern industrial complex from the ground up, a course not available to the victorious allied nations.

Since all of these social and cultural influences cannot be duplicated in the United States, the adaptability of the Japanese economic model on a "supermacro" level is not the issue. The relevant question is whether any particular Japanese economic institutions or policies can be adapted. Since the Japanese trade performance is a hallmark of Japan's economic success, there is especially pronounced U.S. interest in the concept of the trading company, a powerful and uniquely Japanese institution, and its application in the United States.

The roots of Japan's trading companies

The importance of trading companies in Japanese trade and economic growth is undisputed. The share of the 10 largest general trading companies in Japanese exports and imports of more than $250 billion last year was over 50%. If the shares of some 8,000 smaller trading companies are included, trading firms would account for about 75% of all Japanese trade.

The emergence of the Japanese trading company, which traces back to the Meiji era before the turn of the 20th century, was a uniquely Japanese event. Japan's complete ignorance of foreign markets nurtured by a long history of isolation made the acquisition of such knowledge a prerequisite for opening up the country to foreign trade. The trading companies were viewed as a means of consolidating resources and spreading risks in the pursuit of uncertain foreign ventures.

Looking at the general theory of international trade, the economic role that Japanese trading companies play becomes clearer. Traditionally, trade is viewed as a response to existing price (or cost) differentials—the neoclassical trade model—and as the consequence of the maturation of products in domestic markets—the product life cycle theory. New products are introduced in an industrialized country owing to the large size of the home market and the advanced state of technology. Only with these products' gradual maturity in the domestic market and in the presence of international cost differentials is exporting considered. The costs of adjustment to foreign demand patterns and of marketing are naturally high, however. They include transport costs, tariff and nontariff barriers, as well as costs of repackaging and redesign. Substantial one-time investments are also required initially to learn about foreign markets and business practices and to develop contacts. If these costs are excessively high, potential exports are discouraged.

It is just such costs that trading companies reduce through specialization. And once the necessary fixed investment is made in the formation of a trading company, the marginal cost of service to a prospective exporter—as reflected in the fee charged—can be very small. The costs of product adaptation to foreign markets are reduced since the data obtained on foreign markets are incorporated in exporters' initial production plans. The trading companies can also increase the likelihood of any existing cost differentials being exploited, and shorten as well as smooth the transition from domestic to foreign marketing.

Trading company activities

The activities of Japan's trading companies go far beyond simply bringing together domestic firms and foreign customers. Their services include all trade-related activities ranging from handling export and import documents to sourcing finance, warehousing and insuring, and marketing and distribution in foreign countries. The gains from consolidation and specialization are obviously numerous. The trading companies, for example, permit economies of scale in accumulating foreign-business expertise and in gathering information that uncovers otherwise unseen business opportunities, including offshore deals between third-country customers.

Japan's trading companies also perform important financial functions. They are able to provide trade credits

Trading Companies: A Bit of Japan in the U.S. *(continued from page 7)*

or obtain trade financing at favorable rates because of their size and industrial organization: a trading company in Japan is part of a large conglomerate that usually includes banks as well as industrial corporations. Japanese trading companies also assume business risks for their own account. Foreign-exchange risk, for example, is reduced and self-insured by pooling the foreign-exchange risks of various business transactions with long and short exposures to a variety of currencies. This advantage is of particular importance in trade with developing countries where hedging mechanisms (such as forward markets) are nonexistent.

Adaptation in the United States

Although trading companies are the creation of the Japanese, the concept is applicable in other countries since the fundamental justification for them is economic. The need for storehouses of foreign-business expertise and economies of scale in trade servicing certainly exists in the United States as well as in many other countries.

Indeed, trading companies have already been adapted in South Korea and Switzerland; they are also being contemplated in Mexico and Canada. In the United States, the growing concern about international competitiveness of American firms—as well as the fact that the great bulk of U.S. exports are accounted for by only a small percentage of the largest U.S. firms—has generated significant interest in export trading companies. With the relative decline in the United States' traditional technological edge, U.S. firms have to compete increasingly on equal terms in foreign markets. The former American luxury of being able to deal passively with an established list of customers is gone, and active, aggressive marketing by U.S. domestic and multinational firms is now needed to retain or expand international market share.

Although there exists in the United States an abundance of economic information about foreign countries, knowledge and skills specific to foreign marketing are in short supply. U.S. businessmen need to examine foreign markets and be able and willing to adapt their products and services to different cultures and markets. They also need to overcome their traditional prejudice in favor of competition and resistence to bigness (and the resulting economies of scale) to compete internationally, as measures that promote domestic competition among firms can sometimes undermine their international competitiveness.

The growing U.S. concern about international competitiveness has spurred several bills seeking the creation of export trading companies in the United States. The bills now pending in Congress (the Senate has already passed one, while the House is considering no less than five versions) all seek to provide incentives to manufacturing firms—particularly small and medium-sized firms—to form export trading companies to market their products more effectively. The bills call for the relaxation and clarification of anti-trust provisions of U.S. law that would permit trading companies to consolidate export activities. They also authorize equity participation in trading companies by commercial banks. The various bills do differ in how and to what extent certification for anti-trust immunity is carried out and by which government agency, and in whether tax deferral privileges similar to those granted Domestic International Sales Corporations should also be granted to export trading companies.

The real controversy over the trading company legislation centers on both the certification and bank ownership issues. With respect to certification, it would seem that overly stringent requirements would create artificial barriers to market entry. One of the key reasons for these companies' success in Japan is competition within the industry. Relatively free market entry and the existence of numerous small competitors reduce the potential for oligopoly. Thus, certification requirements should be sufficiently non-restrictive to permit broad participation by the manufacturing community. In addition, U.S. trading companies should provide comprehensive services, including import and other trade-related services, in addition to export services.

The various bills pending would also allow commercial banks, their holding companies, and international banking subsidiaries to invest up to 5% of their capital in trading companies with the proviso that all investments over $10 million would require prior regulatory approval. This provision is facing stiff opposition in the House Banking Committee—where concern for the traditional distinction between banking and industry is strong—as well as by the Federal Reserve. Bank participation, is, however, a necessary ingredient for the success of trading companies. Such participation would mean instant availability not only of the necessary capital but also of the trade finance and international market expertise that would help infant trading firms compete with established Japanese trading concerns.

The exact form that U.S. trading company legislation will take is thus quite uncertain at this time. Yet in view of the Reagan administration's concern with U.S. economic revitalization and international competitiveness, and with U.S. government agencies such as the Export-Import Bank decreasingly able to play a large role in facilitating exports, the chances for the ultimate emergence of trading companies in the United States are favorable.

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